

BEFORE THE TENNESSEE STATE BOARD OF EQUALIZATION

In Re: The Estate of Ruth Smith)
 TDOR Account No.: 440490659) Wilson County
 TDOR Case No.: 003886479S)
 Inheritance Tax)

ORDER ON STATE'S MOTION TO DISMISS

This cause came to be heard on the 25th day of July, 2007, before the Honorable Andrei Ellen Lee, Administrative Judge for the State of Tennessee, Administrative Procedures Division for the State Board of Equalization. This appeal involves an inheritance tax assessment on the beneficiary of the Ruth Smith Estate. The Tennessee Department of Revenue filed a Motion to Dismiss this appeal for lack of subject matter jurisdiction, pursuant to Tennessee Code Annotated (T.C.A.) § 67-8-411 (c). Present at the hearing were Attorney Megan Moore, counsel for the Tennessee Department of Revenue and Attorney Bryan Howard of Howard Mobley & Havens, PLLC, counsel for the Petitioner/Taxpayer.

Counsel for the Department of Revenue argues that the State Board of Equalization lacks "subject matter jurisdiction" because there is an issue as to the legality of a "discount" applied by the Internal Revenue Service (IRS) to determine the value of stock held by Ruth Smith Investments for purposes of establishing the value of the estate tax. Attorney Moore states that, since this is the threshold issue in this appeal, the State Board of Equalization does not have jurisdiction.

Counsel for the Taxpayer contends that the only issue of this appeal is the value of various classes of stock in the estate as established by the Tennessee Department of Revenue. Therefore, the State Board of Equalization does, in fact, have jurisdiction in this matter.

At the heart of this appeal are two statutes, T.C.A. § 67-8-411 (c) and T.C.A. § 67-8-208 (a). T.C.A. §67-8-411(c), which deals with relevant jurisdictional issues, states the following:

*The procedure established by this section for review of the appraisal of the commissioner by the state board of equalization shall apply **only if the issue of valuation of the various items of the gross estate is the only objection to be raised to the assessment.** If this procedure for review is selected by the representative of the estate, no challenge to any legal issues that might be raised concerning the inheritance tax assessment shall be entertained in any court or forum. **In all cases in which the representative of the estate seeks to challenge an assessment under this section on any ground other than valuation, the entire proceeding, including***

issues of valuation, must be brought in accordance with §67-1-1801 or §67-1-1802. [Emphasis Supplied]

The second statute, T.C.A. § 67-8-208 (a), is a legislative mandate regarding Tennessee estate taxes relative to federal estate taxes. It states in significant part:

If the amount of federal estate tax is, upon the final determination of the federal estate tax, increased or decreased as affecting an estate the transfer of any part whereof is taxable hereunder subsequent to the payment of the Tennessee estate tax, the Tennessee estate tax imposed shall be changed accordingly. Any additional estate tax shall be payable at the same time or times at which the additional federal estate tax is payable. [Emphasis Added]

From the uncontested facts, it appears that, when the federal estate taxes were filed by the Estate of Ruth Smith, the Internal Revenue Service determined that the estate was undervalued and instituted an audit on the basis of the “undiscounted” value of the decedent’s interest. The Estate had submitted an appraisal of the assets from the Estate, using applied discounts to reach its valuation. During the process of the audit, the IRS increased the amount of the federal estate tax due. The parties came to an “agreement” and settled the disputed amount by applying a fifteen percent (15%) discount for the stocks in the estate and a deduction for a loan. The Taxpayer paid the federal estate tax that was due, pursuant to that agreement. Pursuant to the aforementioned statute, T.C.A. § 67-8-208 (a), the Tennessee Department of Revenue increased the amount of the Tennessee revenue tax that was due. The Taxpayer disagreed with that increase and filed this appeal. (Exhibit A)

Counsel for the Taxpayer contends that, since the Taxpayer has no intention of raising any legal issues and is only contesting the value¹ of the estate, the State Board of Equalization (SBOE) does have jurisdiction² to hear this appeal.

The statute that Attorney Moore cites, T.C.A. §67-8-411 (c), deals with removal of an appeal from the SBOE when, “... *the representative of the estate* seeks to challenge an assessment under this section on any ground other than valuation . . .” However, in this situation, it is the Tennessee Department of Revenue, rather than the “representative of the estate”, that is challenging the method by which the federal government arrived at its values of the estate.

Under Attorney Moore’s interpretation of Internal Revenue Code § 2036.4, it was inappropriate for the IRS to apply discounts in valuing the stocks in the estate because

¹ It should be noted that the Taxpayer had applied discounts to reach its valuation when it originally submitted its appraisal of the decedent’s interest.

² T.C.A. §67-1-1804 The procedure established by this part is the sole and exclusive jurisdiction for determining liability for all taxes collected or administered by the commissioner of revenue, except that the state board of equalization shall have jurisdiction concurrent with the chancery court in inheritance tax cases in which only issues of valuation are raised, as provided by 67-8-411. . . .

Ruth Smith Investments (RSI) retained control over the stocks. Attorney Moore, on behalf of the Tennessee Department of Revenue, makes the following argument:

When I.R.C. § 2036(a) applies to a taxable estate, the assets are brought back into the estate, the family LLC is treated as non-existent, an estate's discounts are rejected, and the decedent's interest is taxed the full undiscounted value.

Upon review and analysis of the arguments and the corresponding statutes, it seems that the Tennessee Department of Revenue is basically contesting the mandate that it has from the legislature to follow T.C.A. § 67-8-208, even if it disagrees with the amount of the change in the federal tax payment or the methodology used to arrive at the amount charged. In its Memorandum in Support of the Motion to Dismiss, the Department stated that, "*The applicability of discounts is a threshold legal inquiry that must be resolved before reaching the factual issue of valuation*".³ Attorney Moore goes further to state:

Here, a ground other than valuation exists. The Respondent [Department of Revenue] argues discounts are inappropriate in this situation, which is a primarily legal argument. A proper resolution of this matter requires a two-fold inquiry. First, the decision maker must determine whether discounts are appropriate. Second, if discounts should be applied, then the decision maker would determine, after hearing testimony of expert appraisers, the correct percentage of discounts in reaching the fair market value of the decedent's interest.

Assuming, arguendo, that the Department of Revenue is correct and the "discounts" should not have been applied in the valuation process, the Department did not, for lack of a better term, have "standing" to contest the application of the discounts or to have its objection heard because it was not a party in the original dispute. The parties in the original dispute were the Federal taxing authority and the Taxpayer. Other than this proceeding, there is no avenue available to the Tennessee Department of Revenue to contest the application of the discounts or the agreement reached by the other parties. It is the mandate by the legislature to the Department of Revenue, through the enactment of T.C.A. § 67-8-208, that is the true issue in this case.

It is apparent that the Taxpayer is satisfied with the action by the Federal taxing authority, because it did not contest or appeal the amount to the Federal authority. The Taxpayer now seeks to force that finding upon the Tennessee Department of Revenue by application of T.C.A. § 67-8-208.

If the Motion to Dismiss is denied, the Department of Revenue could, pursuant to T.C.A. § 4-5-225(a), seek a declaratory judgment and have a court of record review the legality of T.C.A. § 67-8-208(a), pursuant to T.C.A. § 29-14-102. Otherwise, the effect would be that the State of Tennessee would be precluded from contesting and discovering

³ The Department asserts discounts are inappropriate because Ruth Smith Investments (RSI) was invalid for tax purposes pursuant to Internal Revenue Code §2036(a).

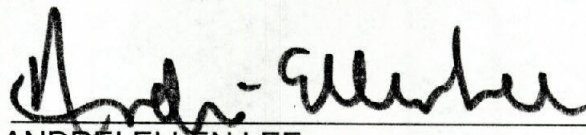
whether giving the discounts to the stock holdings⁴ was, in its opinion, completely inappropriate.

Attorney Howard, counsel for the taxpayer, stated that, if the State's Motion to Dismiss is granted, they are left without redress because it has been more than ninety (90) days since the assessment was received.⁵ Attorney Moore counters that there are, in fact, remedies available to the taxpayer under T.C.A. § 67-1-1802, which give the Taxpayer an avenue of redress.

Recently, in a line of decisions by Administrative Judge Mark Minsky, it is stated, *"The administrative judge finds that the SBOE has continued to have occasion to resolve threshold legal issues that go beyond mere valuation and classification"*. Greenway Golf Center, Inc., et al, IDO Shelby County, Tax Years, 2001 & 2002 at page 5.

Here, it is the Department that seeks to question and challenge the validity of the application of the discounts, not 'the representative of the Estate'. The fact that the State is left without an avenue to address the mandate of the statute is unfortunate. However, it is an issue for the legislative branch to address, not the judicial branch. Therefore, the Department of Revenue's Motion to Dismiss is denied. The case will be docketed for further hearing.

Entered on this the 27th day of September, 2007.



ANDREI ELLEN LEE
ADMINISTRATIVE JUDGE
TENNESSEE DEPARTMENT OF STATE
ADMINISTRATIVE PROCEDURES DIVISION

c: Megan Moore, Esq., Tennessee Department of Revenue
Brian Howard, Esq., Howard Mobley & Havens, PLLC

⁴ Which, as Attorney Moore alleges, is in contradiction of applicable Federal tax statutes.

⁵ T.C.A. § 67-8-411 (b)